AIDS Brief

for sectoral planners and managers

Financial Sector

The HIV/AIDS epidemic is a global crisis, which demands urgent attention and committed, sustained action by alliances of individuals, organisations and sectors. The AIDS Brief series has been developed to support the conceptualisation and implementation of key sectoral responses. Given that the financial sector plays such an important role in economic growth and stability, any increase in uncertainty, if not dealt with effectively, can have a negative impact not only on the sector but also on the entire economy. The HIV/AIDS pandemic represents such an increase in uncertainty. Is the financial sector able to deal with the impact effectively? This AIDS Brief defines the impact of the epidemic on the sector, both internally and externally, and suggests innovative ways to mitigate future impact.

BACKGROUND

Definition of the Financial Sector

The sector can be defined as the group of institutions involved in the pooling of risk and the provision of links between those with surplus funds and those in need of additional funds. Noteworthy among these institutions are banks, building societies, life insurance and medical aid companies, other types of insurance dealers and the stock market.

Facts about the Financial Sector

Worldwide, the financial sector is an integral part of the modern economic system. In its own right it provides a significant contribution to national incomes and without it the functioning and the resultant contribution of the remaining sectors would be greatly hindered. The debate around the economic successes and failures of the East Asian economies has centred on the role of financial institutions and their contribution to economic growth and stability.

Economic development and growth require the services of the financial sector, therefore the more efficient and effective the sector, the better the functioning of the economy. The World Bank notes 'World-wide experience confirms that countries with well developed financial systems grow faster and more consistently than those with weaker systems and are better able to adjust to economic shocks' (World Bank, 1996).

In the developing world establishing and maintaining an efficient and effective financial sector are necessary criteria for sustainable and meaningful economic growth. The need to channel domestic and international capital into investment opportunities requires the services provided by such a sector. Without such investment the prospects for economic growth in the developing world are bleak.

The sector is not only an important ingredient in the growth of the economy, but also in its stability. The East Asian and world financial crises highlighted the dangers of an unstable financial sector. The effects felt throughout the world in response to an interest rate increase in the USA show how the stability of financial systems is interlinked. The financial markets are global and if America sneezes, Mexico catches a cold. The globalisation of the world financial markets makes the need for a strong domestic system even more important. The opportunistic, destabilising and damaging activities of the speculators are targeted at those economies with weaker structures.

The financial system involves a complex set of interrelated institutions. Inter alia, these include banks, life insurance companies, medical aid organisations, pension funds and stock and security markets. The institutions provide service (interest, insurance, medical cover etc.) in exchange for surplus funds, which they then supply at a price (interest etc.), to those who require and can afford them. The issue of uncertainty in performing this function is critical. More so than any other sector, the financial sector's day-to-day operations concern expectations of future situations. The banking sector is concerned with the future profitability and earnings of the companies and individuals to whom it lends. The insurance industry is concerned with the life expectancy of those with life cover and the future health of those with medical cover. Similar uncertain futures affect the remaining members of the sector.

AIDS AND THE FINANCIAL SECTOR

The pandemic will impact on the sector via a number of channels. Internally the workforce will be affected; externally the clients and customers will be affected. Both will have an impact on the operation of the company. In addition to this the operation of the company will interact with the pandemic itself.

Labour

The financial sector, although not a major employer like mining or manufacturing, employs mainly highly skilled, experienced and qualified staff. Such staff often have a tertiary education or have studied for institutional qualifications. The high levels of qualified staff make the financial sector staff relatively well paid, with the associated benefits. The composition of the financial sector's labour force makes it vulnerable to the impacts of the pandemic. Whether this vulnerability will be exposed will be determined by the susceptibility of its employees to infection. A number of factors will influence the susceptibility of companies, classes of employees and individuals. They include the location of the place of business, the location of employees' families in relation to the place of business, the travel requirements of employment, the level of knowledge of HIV, and individual risk behaviour.

If the business is located or operates in an area with a high prevalence, the susceptibility of employee infection is clearly higher than if located in areas with minimal infection rates. Financial institutions exist throughout the world: clearly many operate in regions with high levels of infection. If employees work away from home and tend to be separated from their families for long periods of time, the susceptibility to infection increases. This has been evident in the mining sector and other migrant labour operations. In the financial sector the operations of one company may span the country or even the globe. Employees may well be transferred to different parts of the operation. This, however, is not seen as a significant risk factor, as such staff will usually be seconded or sent on contract and have the opportunity to take their families. Thus long-term transfers may not be associated with increased risk, but short-term business trips could increase the risk (See *Tourism Sector*). This also applies to employees who travel as part of their everyday employment. Insurance sales representatives, for example, may cover large areas and be required to stay away from home.

A major determinant of the susceptibility of the workforce to infection is their level of knowledge of HIV and their risk profile. Knowledge and behaviour vary substantially in all sectors of the economy and all parts of the population. There is no reason to believe that such variation does not exist within the financial sector, and that there exist employees with low levels of knowledge and high levels of risk behaviour.

Morbidity

As infected employees become ill they will take additional sick leave: this will disrupt the operation of the institution for which they work. The disruption will be amplified when the more qualified and experienced employees are absent, as finding a temporary replacement is that much more difficult. In some areas of the financial sector, problems could occur where personal relationships with clients have been built up involving trust. Such clients may not be happy dealing with new people, as relationships may have taken years to build. In some sub-sectors the fast moving nature of operations means that a day's absence of a key employee could have large monetary implications. For example the absence of a stockbroker could have dangerous implications for his/her clients. The impact of morbidity will depend on a number of factors - company policy, labour law, the availability of appropriate temporary staff or current staff who can fulfil the duties of those absent, and the level of infection within the company.

Mortality or retirement

The impact of the death or retirement of an infected employee is similar to morbidity, although the problems are permanent. The loss of an employee requires an appropriate replacement to be selected and trained. For highly qualified staff this is often difficult, particularly in developing economies with skill shortages. Training and recruitment are costly and disrupt operations. Again, as with morbidity, personal client relationships may have to be rebuilt. Additional costs may also occur depending on the benefit structure of the company regarding death and retirement. As mentioned, the composition of financial sector staff makes them, on average, more highly paid than most other sectors. High pay generally coincides with generous benefits. These characteristics increase the vulnerability of the sector, with higher than average payouts.

Absenteeism

As the HIV/AIDS pandemic advances, areas with high levels of infection will display a marked increase in deaths. This may lead to increased absenteeism or compassionate leave, if this is available, as workers attend funerals for family, friends and co-workers. This will have a similar impact as the taking of additional sick leave discussed above, with a further negative impact on staff morale, particularly with the death of co-workers.

In summary, the sector's dependence on educated and well-remunerated staff makes it vulnerable to the impact of HIV/AIDS through morbidity, mortality, retirement, absenteeism, training and recruitment costs and low staff morale resulting from the infection of employees. The commonly held belief of the association of the epidemic with the poor, unhealthy and ill-educated should not lead to the conclusion that the well-off, well educated and healthy workforce of the financial sector are immune to infection.

Operations and Services

Although a number of similarities exist between the different institutions which comprise the financial sector, the services and operations vary substantially. The impact of AIDS on a number of operations will be explored, but this is not intended as a definitive list, but rather as the highlighting of some possible impacts.

Life insurance *(see Brief for Insurance Personnel)*

The pandemic will have a direct impact on the life insurance industry as claims escalate as a result of increasing deaths. Loading premiums to counter this increase is difficult in competitive market conditions where players are attempting to gain and protect market share. The problems are compounded by anti-selection (deliberate concealment of poor health on application), where people seek life cover knowing that they are infected.

Excluding HIV positive people from claiming benefits or gaining cover was the first reaction of the industry. This, however, has led to a number of other problems. Firstly, there is the information disclosure problem, which exists at proposal and claim stages. Secondly, there is the image of the industry to consider, as such exclusions would affect a substantial number of claims in high prevalence settings.

The first problem can be solved at the proposal stage by testing applicants for HIV. While solving one problem it introduces others, such as testing costs: if international protocols are followed the cost is increased with the inclusion of counselling and other related costs. If the prevalence in the target population were low the introduction of testing would lead to reduced profits. Furthermore, the introduction of testing discourages some applicants from continuing with the process; some of them may not be infected but do not want to be tested. This represents a loss of business, in addition to applications refused from those found to be HIV positive. A possible solution is to limit testing to cover in excess of some critical value determined by the estimated prevalence in the target population. This in turn may lead to an increase in the demand for lower levels of cover to avoid the test, with the associated anti-selection problems. Brokers may encourage such practices, as positive test results would have a negative impact on their earnings. Unless more innovative measures are introduced, the insurance industry is likely to be facing reduced profits and business while trying to market products which would become increasingly less attractive, particularly to low-risk individuals.

The impacts on the life insurance industry have implications for other financial services. Credit sale, for example, often requires that the purchaser take out life insurance so that in the event of death the remaining debt is paid off. Any problems and additional costs associated with the insurance cover will therefore affect credit sales. More significantly, similar impacts may be felt by the mortgage industry, which also has occasion to demand life cover.

Pension funds and funeral cover

Pension funds and funeral cover face many of the same problems as the life insurance industry. An additional area of concern for this area is group cover and group life cover, particularly for employees. Conventional wisdom was that group insurance costs less than individual cover. The advent of the AIDS pandemic challenges such conventions. Death payments, early retirements, funeral payments and pensions paid to families after the contributor's death will all lead to an increase in the cost of group cover. This is partly offset by reduced demand for normal pensions. Increasing premiums make products less appealing and will have a negative impact on sales and industry profits. Employers, therefore, will feel the impact as the cost of employee benefits increases and the providers of such benefits lose as their products and services become more expensive.

Medical aids

This is the most obvious area on which the pandemic will impact. The cost of treating HIV and the related illness is substantial, and attempts to contain these by excluding them from cover are futile. Containing risk by exclusion fails as the symptoms are still covered. Thus, even if the treatment of HIV is excluded, the treatment of the symptoms can still have a significant impact on costs. Such exclusions further encourage non-disclosure, thereby reducing the use of prophylactic treatments - which may in the long run reduce costs. The huge costs associated with the pandemic will find their way into medical schemes and if not dealt with effectively will place a major financial strain on them. As with other benefits, this strain will be felt by the financial institutions and employers who offer the benefit to their employees, as the costs of a given benefit increase.

Stock markets and investment banking

The impact on the operations of stock markets and investment banking are uncertain. There are two possible routes through which the impact might be felt. Firstly, AIDS adds another uncertain factor to an already uncertain environment. This may have a negative impact on investment in those areas with high levels of infection. Analysis often includes the impact of AIDS on the operations of some companies when assessing the value, although experts suggest that it is difficult to separate the additional uncertainty from that which already exists. Secondly, in the financial sector, and especially the stock market, profits are positively related to the performance of the economy. If AIDS has a negative impact on the performance of an economy the financial sector within that economy will also suffer. The future impact of AIDS, however, on macro-economies is very uncertain, and to conclude that the financial sector would be impacted on via this means is equally so.

External Interactions

At the international level, the financial sector increases the mobility of capital and people. This may contribute to the spread of HIV if the mobile members of the sector practise high-risk sexual behaviour. Similarly at country level, the mobility of the sector's staff could have negative implications.

More importantly, however, is the impact the sector has on the public perception of the virus. An effort to exclude HIV positive clients from life and medical cover encourages non-disclosure and adds to the stigma associated with HIV infection. The policies of the financial sector have contributed to the concealment of these problems. Life covers, which exclude HIV-related deaths, prompt claimants and sympathetic doctors to cover up the underlying cause of death. Openness and the removal of the stigma are important in the fight against AIDS. In hindering the achievement of these goals, the financial sector contributes to the problem.

On a more positive note, the testing and counselling of applicants increase knowledge and awareness of the pandemic. They provide opportunities for education, possibly promoting a change in behaviour.

IMPACT CHECKLIST

Internal risk profile

- ✓ Are operations dependent on highly educated employees?
- ✓ Is there a shortage of appropriate skills in the local labour market?
- ✓ Are generous benefits included as part of the employment package?
- ✓ Are the employees highly mobile? Are their families?
- ✓ Is the business reliant on personal relationships between employees and clients?
- ✓ What is the level of knowledge of HIV/AIDS in the workplace?
- ✓ Are efforts being made to improve knowledge?
- ✓ Are training and recruitment costs high?
- ✓ Is the training programme flexible?

External risk profile

- ✓ Does current business rely heavily on estimates of future uncertain events?
- ✓ Is the market for which the service is provided highly competitive?
- ✓ Does the target market have a high level of infection?
- ✓ Will an increase in the number of deaths in the target market increase the cost of the marketed service?

SECTORAL RESPONSE

Limiting susceptibility

Reducing the susceptibility of the workforce will greatly reduce the susceptibility of the sector. A number of steps can be taken towards this end. Ensuring that employees are well educated on the modes of transmission and the dangers of HIV is the most important. Efforts should be targeted at those who are at higher risk, for example staff who travel considerably. Such groups of employees could also be provided with condoms. Employees spend a large part of their time at work and workplace education campaigns have been shown to be an effective way of combating the epidemic. The level of an employer's involvement can vary from providing space for educators to actively supporting such education with time and money. The greater the support the more effective campaigns will be, but the decision of how far to go should rest with employers and will depend on their perception of the vulnerability of the company to losing labour, and their level of social responsibility.

Reducing impact

Labour

The vulnerability of the financial sector to labour disruptions has already been mentioned. There are, however, a variety of responses that can reduce this vulnerability. Early and appropriate treatment, for instance, can extend the working lives of infected employees and postpone the time when employment will have to be terminated. This is to the advantage of the employee, families, employers and the state. Also, as there is a direct relationship between the spread of HIV/AIDS and STDs, these should be treated where possible.

Counselling is another example, as it promotes awareness and enables the employer to encourage infected employees to remain in employment and provides them with information on any benefits which are due to them.

Another response, which has the effect of reducing the vulnerability of the sector, is multi-skilling. This is especially useful where there is a dependence on a few key individuals: it involves the training of employees to perform more than one task. This increases flexibility and minimises disruptions caused by increased sick leave and absenteeism.

Life insurance

The initial reaction of the life insurance industry has generally been that of exclusion of HIV claims. The problems of disclosure have already been mentioned, as well as the possible loss of business. Some insurers have, however, come up with more innovative solutions. For example, some group life schemes have been changed from a defined benefit system to a defined contribution model. Defined benefits operate by determining the level of cover required and then calculating the premium. Thus as AIDS takes effect the premiums escalate as the cost of providing such cover increases. Defined contribution, on the other hand, works in the opposite direction. An affordable contribution is determined and the cover available is calculated from that premium. Although this reduces the cover it allows policies to remain affordable. This has often been coupled with a move away from group to individual cover, further allowing the containment of costs. Some insurers have gone so far as to introduce insurance policies that pay out in the event of the insured having AIDS. The more innovative reactions allow the industry to limit the loss of business and even attract some new clients.

Innovative responses have also occurred in the banking sector to address the need for life cover over mortgages. One response makes use of a coupon product. No medical examination is required: a form is used instead. The bank makes judgements as to whether or not to provide cover based on the information on the form. The cover is then loaded according to estimates of the number of people who withhold information which would have led to their application being refused. The banks that have introduced such in-house methods of insurance have found that claims have remained within the estimated boundaries.

Pension funds and funeral cover

The response here has been very similar to the insurance industry – the move away from group cover and towards defined contribution rather than defined benefits. Additional measures can and have been introduced, especially to limit the impact of anti-selection. Longer waiting periods before full cover is granted and strengthened underwriting are two such measures.

Medical aid

Excluding HIV from medical cover is a counter-productive exercise. Schemes still end up paying for the treatment of symptoms and often the associated hospital cover. Rewarding early disclosure of infection with meaningful treatment and providing managed access to benefits allows for more effective cost containment. Avoiding hospitalisation, particularly with the use of prophylactic drugs has, in many cases, proved to be cost-saving. In some instances the use of anti-AIDS drugs is cost-saving, because they reduce the amount of hospitalisation and keep employees at work and paying premiums. Again the more innovative responses have reduced the impact. Those who continue simply to exclude and run away from the problems will face greater strains in the future than those that implement innovative responses now.

Stock markets and investment banking

Including the impact of HIV in modelling and valuations will allow for a reduction in uncertainty. When valuations and modelling exercises have included the impact of AIDS they have usually only included the external impact. For example, when valuing companies, the impact of AIDS on the market for their product is included, but the internal implications are largely ignored. If uncertainty is to be reduced further, more study of the internal implications of AIDS for operations in high prevalence areas needs to be undertaken.

AIDS modelling has not been confined to the investment sector. Financial institutions have been making use of projections, particularly in the insurance industry. This is dangerous unless the correct models are used. Uninformed use of AIDS models can result in gross errors. The use, for example, of a national model in the framework of a single company would more than likely yield misleading results. Models that can be adjusted to more specific settings are now being used and the improvement of these will help mitigate the impact.

ACTION CHECKLIST

- ✓ Promote and support workplace education programmes
- ✓ Encourage voluntary testing
- ✓ Provide counselling for infected employees
- ✓ Ensure the provision of treatment to keep employees working
- ✓ Identify key sections and employees
- ✓ Train employees to be multi-skilled
- ✓ Develop and use appropriate models of the impact of the pandemic on operations
- ✓ Identify market risks
- ✓ Analyse changing market conditions.
- ✓ Innovate:
  - ■ Find ways to reduce market risk
  - ■ Find ways to reduce the sector's contribution to the stigma around HIV/AIDS
  - ■ Prevent substantial and unnecessary loss of business
  - ■ Find new products for the infected
- ✓ Innovate some more

SUMMARY

The financial sector is an integral part of the world economy. Investment, stability and economic growth in the developing world are dependent on the establishment and maintenance of a functioning set of financial institutions. The HIV/AIDS pandemic threatens to have, and in some cases has already had, a major impact on the sector. The sector depends on the skills of highly educated employees: if they become ill and die operations could be severely affected.

The services offered by the sector often involve the assessment of risk. The HIV/AIDS pandemic threatens to complicate the situation and to increase the cost of offering some of these services. There are, however, a number of innovative responses that have emerged, and continue to evolve. These responses help limit impact, but more are needed.

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Useful contacts : Websites

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Metropolitan life: www.metropolitan.co.za
Old Mutual: www.oldmutual.co.za
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